U.S. SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q

(Mark One)

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR (15)d OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 1998

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period ____________ to ____________

Commission file number 001-13957

CAVANAUGHS HOSPITALITY CORPORATION
(Exact name of registrant as specified in its charter)

Washington	91-1032187
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

201 W. North River Drive, Suite 100, Spokane, WA 99201
(Address of principal executive office)

(509) 459-6100
(Issuer's telephone number)

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes X No ____

As of July 31, 1998, there were 13,053,576 shares of the Registrant's common stock outstanding.

CAVANAUGHS HOSPITALITY CORPORATION

Form 10-Q
For the Quarter Ended June 30, 1998

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Part I - Financial Information
ITEM 1. FINANCIAL STATEMENTS

CAVANAUGHS HOSPITALITY CORPORATION
CONSOLIDATED BALANCE SHEETS (UNAUDITED)
December 31, 1997 and June 30, 1998
(in thousands, except share data)

	December 31, 1997	June 30, 1998
ASSETS		
Current assets:		
Cash and cash equivalents	$ 4,955	$ 6,227
Accounts receivable	2,785	4,762
Note receivable		17,112
Inventories	427	545
Prepaid expenses and deposits	1,100	370
Total current assets	9,267	29,016
Property and equipment, net	112,234	152,701
Other assets, net	3,616	6,351
Total assets	$125,117	$188,068
LIABILITIES AND STOCKHOLDERS' AND PARTNERS' EQUITY		
Current liabilities:		
Payable to affiliate	$ 1,133	
Note payable to bank	1,075	
Accounts payable	3,234	$ 3,701
Accrued payroll and related benefits	983	1,693
Accrued interest payable	689	454
Other accrued expenses	2,882	3,429
Long-term debt, due within one year	3,590	1,374
Capital lease obligations, due within one year	502	519
Total current liabilities	14,088	11,170
Long-term debt, due after one year	94,419	72,691
Capital lease obligations, due after one year	2,139	2,079
Deferred income taxes	5,415	5,415
Minority interest in partnerships	524	4,246
Total liabilities	116,585	95,601
Commitments and contingencies		

CAVANAUGHS HOSPITALITY CORPORATION
CONSOLIDATED BALANCE SHEETS (UNAUDITED), CONTINUED
December 31, 1997 and June 30, 1998
(in thousands, except share data)

December 31, June 30,

	1997	1998
Stockholders' and partners' equity:		
Preferred stock - 5,000,000 shares authorized, $0.01 par value, -0- shares issued and outstanding	$ --	$ --
Common stock - 50,000,000 shares authorized, $0.01 par value; 7,084,254 and 13,053,345 shares issued and outstanding	71	131
Partners' deficit	(879)	
Additional paid-in capital	3,935	84,896
Retained earnings	5,405	7,440
Total stockholders' and partners' equity	8,532	92,467
Total liabilities and stockholders' and partners' equity	$125,117	$188,068

The accompanying notes are an integral part of the consolidated financial statements.

CAVANAUGHS HOSPITALITY CORPORATION
CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME
(UNAUDITED)
for the three and six months ended June 30, 1997 and 1998
(in thousands, except per share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	1997	1998	1997	1998
Revenues:				
Hotels and restaurants				
Rooms	$ 7,028	$11,668	$11,419	$18,552
Food and beverage	3,583	5,683	6,478	9,858
Other	692	965	1,307	1,747
Total hotels and restaurants	11,303	18,316	19,204	30,157
Entertainment, management and services	798	1,008	1,810	2,026
Rental operations	1,602	1,738	3,220	3,514
Total revenues	13,703	21,062	24,234	35,697
Operating expenses:				
Direct:				
Hotels and restaurants:				
Rooms	1,765	2,954	3,192	5,045
Food and beverage	2,874	4,602	5,320	8,160
Other	249	440	475	777
Total hotels and restaurants	4,888	7,996	8,987	13,982
Entertainment, management and services	463	718	1,078	1,415
Rental operations	371	347	738	732
Total direct expenses	5,722	9,061	10,803	16,129
Undistributed operating expenses:				
Selling, general and administrative	2,081	3,070	3,801	5,065
Property operating costs	1,311	2,177	2,556	3,977
Depreciation and amortization	1,160	1,417	2,296	2,736
Total undistributed operating expenses	4,552	6,664	8,653	11,778
Total expenses	10,274	15,725	19,456	27,907
Operating income	3,429	5,337	4,778	7,790
Other income (expense):				

Interest expense, net of amounts capitalized	(2,245)	(1,360)	(4,600)	(4,054)
Interest income	77	126	170	196
Other income			346	
Minority interest in partnerships	(9)	(85)	39	(45)

CAVANAUGHS HOSPITALITY CORPORATION
CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME
(UNAUDITED), CONTINUED
for the three and six months ended June 30, 1997 and 1998
(in thousands, except per share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	1997	1998	1997	1998
Income before income taxes and extraordinary item	$ 1,252	$ 4,018	$ 733	$ 3,887
Income tax provision	426	1,366	252	1,322
Income before extraordinary item	826	2,652	481	2,565
Extraordinary item -- write off of deferred loan fees, net of tax		(530)		(530)
Net and comprehensive income	$ 826	$ 2,122	$ 481	$ 2,035
Income per share before extraordinary item	$ 0.12	$ 0.21	$ 0.07	$ 0.26
Net income per share:				
Basic	$ 0.12	$ 0.17	$ 0.07	$ 0.21
Diluted	$ 0.12	$ 0.17	$ 0.07	$ 0.21
Weighted-average shares outstanding:				
Basic	7,072	12,588	7,072	9,836
Diluted	7,072	12,920	7,072	10,077

The accompanying notes are an integral part of the consolidated financial statements.

CAVANAUGHS HOSPITALITY CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)
for the six months ended June 30, 1997 and 1998
(in thousands)

	1997	1998
Operating activities:		
Net income	$ 481	$ 2,035
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	2,296	2,736
Minority interest in partnerships	(39)	45
Extraordinary item -- write off of deferred loan fees		530
Change in:		
Accounts receivable	(19)	(1,977)
Inventories	(11)	(118)
Prepaid expenses and deposits	(10)	730
Other assets		(275)
Accounts payable	(109)	467

Accrued payroll and related benefits	176	710
Accrued interest payable	64	(235)
Other accrued expenses	(808)	813
Net cash provided by operating activities	2,021	5,461
Investing activities:		
Additions to property and equipment	(3,368)	(27,769)
Proceeds from disposition of property and equipment	703	
Issuance of note receivable		(17,112)
Deposit for acquisition of hotel		(1,980)
Other, net	(36)	(283)
Net cash used in investing activities	(2,701)	(47,144)
Financing activities:		
Redemption of common stock	(163)	
Distributions to stockholders and partners	(1,124)	
Dividends to stockholders	(177)	
Proceeds from issuance of common stock under employee stock purchase plan		242
Net proceeds from initial public offering of common stock		81,659
Proceeds from note payable to bank		1,925
Repayment of note payable to bank		(3,000)
Proceeds from long-term debt	4,352	32,971
Repayment of long-term debt	(1,712)	(68,319)
Payments to affiliate		(1,133)

CAVANAUGHS HOSPITALITY CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)
for the six months ended June 30, 1997 and 1998
(in thousands)

	1997	1998
Financing activities, Continued:		
Principal payments on capital lease obligations	$ (219)	$ (267)
Payment of loan fees		(1,123)
Net cash provided by financing activities	957	42,955
Change in cash and cash equivalents:		
Net increase in cash and cash equivalents	277	1,272
Cash and cash equivalents at beginning of period	5,703	4,955
Cash and cash equivalents at end of period	$ 5,980	$ 6,227
Supplemental disclosure of cash flow information:		
Cash paid during period for:		
Interest (net of amount capitalized)	$ 4,536	$ 3,819
Income taxes	125	
Noncash investing and financing activities:		
Acquisition of leases		222
Issuance of operating partnership units for property acquisitions		4,557
Acquisition of property through assumption of debt and capital leases		11,404

The accompanying notes are an integral part of the consolidated financial statements.

CAVANAUGHS HOSPITALITY CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. QUARTERLY INFORMATION:

The unaudited consolidated financial statements included herein have been prepared by Cavanaughs Hospitality Corporation (the Company) pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted as permitted by such rules and regulations. The balance sheet as of December 31, 1997 has been derived from the audited balance sheet as of such date. The Company believes that the disclosures included herein are adequate; however, these consolidated statements should be read in conjunction with the financial statements and the notes thereto for the period ended December 31, 1997 previously filed with the SEC on Form S-1 which was effective in April 1998.

In the opinion of management, these unaudited consolidated financial statements contain all of the adjustments normal and recurring in nature, necessary to present fairly the consolidated financial position of the Company at June 30, 1998 and the consolidated results of operations and cash flows for the three and six months ended June 30, 1998 and 1997. The results of operations for the periods presented may not be indicative of those which may be expected for a full year.

2. ORGANIZATION:

At June 30, 1997, the Company controlled and operated (through ownership or lease with purchase option agreements) seven hotel properties. At June 30, 1998, the Company controlled and operated 14 hotel properties in Seattle, Spokane, Yakima and Kennewick, Washington; Post Falls and Idaho Falls, Idaho; Kalispell, Montana; Hillsboro, Oregon; and Salt Lake City, Utah under its Cavanaughs(TM) brand. Additionally, the Company provides computerized ticketing for entertainment events and arranges Broadway and other entertainment event productions. The Company also leases retail and office space in buildings owned by the Company and manages residential and commercial properties in Washington, Idaho and Montana. The Company's operations are classified into three divisions: (1) hotels and restaurants, (2) entertainment, management and services, and (3) rental operations.

Prior to January 1, 1998, the financial statements included the combined operations of Cavanaughs Hospitality Corporation (including its merged and predecessor entities) and G&B: Lincoln Building Limited Partnership (Lincoln Building). On January 1, 1998, the Company issued common stock and units in the Cavanaughs Hospitality Limited Partnership (OP Units) to the partners of

2. ORGANIZATION, CONTINUED:

Lincoln Building in exchange for the assets and liabilities of Lincoln Building. Therefore, consolidated financial statements of the Company are presented at June 30, 1998.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

New Accounting Pronouncements

In June 1997, SFAS No. 130, "Reporting Comprehensive Income", was issued. This Statement requires that comprehensive income be reported in a financial statement that is displayed with the same prominence as other financial statements. This Statement does not require a specific format for the financial statement, but requires that an enterprise display net income as a component of comprehensive income in the financial statements. Comprehensive income is defined as the change in equity of a business enterprise arising from non-owner sources. The classifications of comprehensive income under current accounting standards include foreign currency items, minimum pension liability adjustments, and unrealized gains and losses on certain investments in debt and equity securities. The implementation of this standard on January 1, 1998 did not have a material impact on the presentation of the Company's consolidated financial statements.

In June 1997, the Financial Accounting Standards Board issued SFAS No. 131, "Disclosures about Segments for an Enterprise and Related Information". This Statement will change the way public companies report information about segments of their business in their annual financial statements and requires them to report selected segment information in their quarterly reports issued to shareholders. It also requires entity-wide disclosures about the products and services an entity provides, and its major customers. The implementation of SFAS No. 131 on January 1, 1998 did not have a material impact on the consolidated financial statements.

4. INITIAL PUBLIC OFFERING:

In April 1998, the Company completed an initial public offering (Offering) of 5,951,250 shares of common stock. The proceeds, after deducting the underwriting discount and before offering expenses, of approximately $83.0 million were used to repay certain debt and acquire hotel properties.

5. 1998 ACQUISITIONS:

In January 1998, the Company entered into a lease with purchase option to acquire certain assets of a hotel in Spokane, Washington for approximately $11.5 million and acquired certain assets of a hotel in Idaho Falls, Idaho for approximately $3.8 million. In April 1998, the purchase option on the Spokane, Washington hotel was exercised. In February 1998, the Company acquired certain assets of a hotel in Post Falls, Idaho for approximately $9.5 million. In April 1998, the Company acquired certain assets of a hotel in Hillsboro, Oregon for approximately $5.5 million. In June 1998, the Company acquired certain assets of a hotel in Kalispell, Montana for approximately $9.6 million. In June 1998, the Company acquired, through a management and purchase agreement, The Olympus Hotel and Conference Center, located in Salt Lake City, Utah. The final closing on the purchase of the assets was made on July 1, 1998 for a total price of $31.6 million. A Current Report on Form 8-K/A was filed with the SEC on August 13, 1998, which included the pro forma disclosures of the acquisition.

All of these acquisitions have been accounted for using the purchase method of accounting. Accordingly, the results of operations of these hotels have been included in the consolidated statement of operations since their respective dates of acquisition. The excess purchase price of the assets over their historical cost bases has been allocated to property and equipment and is being depreciated over the estimated remaining useful life of the related assets. Pro forma disclosures reflecting these acquisitions have been included in the Company's Form S-1 and Form 8-K/A as previously filed with the SEC.

On July 31, 1998, the Company acquired four additional hotels for $30.3 million from one seller. The hotels are located in Boise, Twin Falls and Pocatello, Idaho and Helena, Montana. This acquisition will be accounted for using the purchase method of accounting.

The Company used the net proceeds of the initial public offering to repay $68.3 million of debt. In connection with the debt repayment, approximately $530,000 of deferred loan fees and prepayment penalties, net of income taxes, were charged to operations during the second quarter of 1998 and are presented as an extraordinary item.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED

6. LONG-TERM DEBT AND LINE OF CREDIT, CONTINUED:

In May 1998, the Company obtained an $80 million revolving secured credit facility with a bank (Revolving Credit Facility). The credit facility requires that the Company maintain certain financial ratios and minimum levels of cash flows. Any outstanding borrowings bear interest based on prime rate or LIBOR. The credit facility matures in five years. The credit facility requires the payment of a 1% fee plus an annual standby fee of 0.25%. At June 30, 1998, $26,050,000 is outstanding under the credit facility. The Company was in compliance with all required covenants at June 30, 1998

7. CONTINGENCY:

In 1994, the Company was sued by the contractor who constructed one of the Company's hotel properties asserting lack of payment of cost overruns. The Company filed a counter claim for the recovery of various damages. The Company obtained summary judgment for most of the claims. As of June 30, 1998, the amount of claims against the Company which have not been dismissed or are subject to appeal is $233,000, plus interest. The Company's counter claims which have not been dismissed are $419,000. Management believes that the ultimate resolution of this matter will not have a material effect on the Company's results of operations, financial condition or cash flows.

8. EARNINGS PER SHARE:

The following table presents a reconciliation of the numerators and denominators used in the basic and diluted EPS computations (in thousands, except per share amounts). Also shown is the number of dilutive securities (stock options) that would have been included in the diluted EPS computation if they were not anti-dilutive.

	Three Months Ended June 30,		Six Months Ended June 30,	
	1997	1998	1997	1998
Numerator:				
Income before extra-ordinary item	$ 826	$ 2,652	$ 481	$ 2,565
Extraordinary item	--	(530)	--	(530)
Net income after extra-ordinary item - basic	826	2,122	481	2,035
Income effect of dilutive OP Units	--	85	--	82
Net income after extra-ordinary item - diluted	$ 826	$ 2,207	$ 481	$ 2,117
Denominator:				
Weighted-average shares outstanding - basic	7,072	12,588	7,072	9,836
Effect of dilutive OP Units	--	332	--	241
Effect of dilutive common stock options	--	(A)	--	(A)
Weighted-average shares outstanding - diluted	7,072	12,920	7,072	10,077
Earnings Per Share - basic and diluted				

Income per share before extraordinary item	$ 0.12	$ 0.21	$ 0.07	$ 0.26
Extraordinary item	--	(0.04)	--	(0.05)
Net income per share - basic and diluted	$ 0.12	$ 0.17	$ 0.07	$ 0.21

(A) For the six and three months ending June 30, 1998, 591,028 stock options were excluded from the calculation of diluted earnings per share because there would be no effect as the exercise price of the options is greater than the current market value.

CAVANAUGHS HOSPITALITY CORPORATION

Part I - Financial Information

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

General

The following discussion and analysis addresses the results of operations for the Company for the three and six months ended June 30, 1997 and 1998. The following should be read in conjunction with the unaudited Consolidated Financial Statements and the notes thereto. In addition to historical information, the following Management's Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements that involve risks and uncertainties. The Company's actual results could differ significantly from those anticipated in these forward-looking statements as a result of certain factors, including those discussed in "Risk Factors" and elsewhere in the Form S-1 filed originally by the Company in April 1998 (File No. 333-44491)

The Company's revenues are derived primarily from the Hotels and reflect revenue from rooms, food and beverage and other sources, including telephone, guest services, banquet room rentals, gift shops and other amenities. Hotel revenues accounted for 84.5% of total revenue in the six months ended June 30, 1998 and increased 57.0% from $19.2 million in 1997 to $30.2 million in 1998. This increase was primarily the result of the addition of seven hotels in the period and an increase in revenue per available room (REVPAR) from the hotels owned for greater than one year ("Comparable Hotels") of $42.21 in 1997 to $49.47 in 1998, a 17.2% increase. The balance of the Company's revenues are derived from its entertainment, management and services and rental operations divisions. These revenues are generated from ticket distribution handling fees, real estate management fees, sales commissions and rents. In the six months ended June 30, 1998, entertainment, management and services accounted for 5.7% of total revenues and rental operations accounted for 9.8% of total revenues. These two divisions are expected to represent a smaller percent of total revenues in the future as the Company continues to pursue its hotel growth strategy.

As is typical in the hospitality industry, REVPAR, average daily rates (ADR) and occupancy levels are important performance measures. The Company's operating strategy is focused on enhancing revenue and operating margins by increasing REVPAR, ADR, occupancy and operating efficiencies of the Hotels. These performance measures are impacted by a variety of factors, including national, regional and local economic conditions, degree of competition with other hotels in their respective market areas and, in the case of occupancy levels, changes in travel patterns.

The following table sets forth selected items from the consolidated statements of income and comprehensive income as a percent of total revenues and certain other selected data:

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	Three Months Ended June 30, 1997	1998	Six Months Ended June 30, 1997	1998
Revenues:				
Hotels and restaurants	82.5%	87.0%	79.2%	84.5%
Entertainment, management and services	5.8	4.8	7.5	5.7
Rental operations	11.7	8.2	13.3	9.8
Total revenues	100.0%	100.0%	100.0%	100.0%
Direct operating expenses	41.8%	43.0%	44.6%	45.2%
Undistributed operating expenses:				
Selling, general and administrative	15.2	14.6	15.7	14.2
Property operating costs	9.5	10.4	10.5	11.1
Depreciation and amortization	8.5	6.6	9.5	7.7
Total undistributed operating expenses	33.2	31.6	35.7	33.0
Operating income	25.0	25.4	19.7	21.8
Interest expense, net	15.9	5.9	18.3	10.9
Other income	--	--	1.6	--
Income before income taxes and extra-ordinary item	9.1	19.1	3.0	10.9
Income tax provision	3.1	6.5	1.0	3.7
Income before extraordinary item	6.0%	12.6%	2.0%	7.2%
Comparable Hotels:				
REVPAR	$51.49	$56.48	$42.21	$49.47
ADR	77.55	83.35	72.65	79.79
Occupancy	66.40%	67.80%	58.1%	62.0%

RESULTS OF OPERATIONS

COMPARISON OF SIX MONTHS ENDED JUNE 30, 1998 TO SIX MONTHS ENDED JUNE 30, 1997

Total revenues increased $11.5 million, or 47.3%, from $24.2 million in 1997 to $35.7 million in 1998. This increase is attributed primarily to revenue generated from increases in total rooms occupied and REVPAR and the addition of seven hotels.

Total hotel and restaurant revenues increased $11.0 million, or 57.0%, from $19.2 million in 1997 to $30.2 million in 1998. ADR for the seven Comparable Hotels increased $7.14, or 9.8%, from $72.65 in 1997 to $79.79 in 1998. Available room nights increased 61.9% in 1998. REVPAR for the seven Comparable Hotels increased $7.26, or 17.2% from $42.21 in 1997 to $49.47 in 1998. The results reflect the addition of Cavanaughs Gateway Hotel, Cavanaughs Ridpath Hotel, Cavanaughs on the Falls, Cavanaughs Outlaw Hotel, Cavanaughs Olympus Hotel, Cavanaughs Hillsboro Hotel and Cavanaughs Templin's Resort which contributed, in part, to this increase in revenues.

Entertainment, management and services revenues increased $217,000, or 12.0% in 1998. Management and services revenue increased from the addition of new third-party management contracts.

Rental income increased $293,000, or 9.1%, from $3.2 million in 1997 to $3.5 million in 1998. This increase is due primarily to the addition of leased space in the Crescent Court property to The Travelers company which commenced occupancy in January 1998.

Direct operating expenses increased $5.3 million, or 49.3%, from $10.8 million in 1997 to $16.1 million in 1998, primarily due to the increase in the number of hotel guests served and the addition of seven hotels.

This represents an increase in direct operating expenses as a percentage of total revenues from 44.6% in 1997 to 45.2% in 1998.

Total undistributed operating expenses increased $3.1 million, or 36.1%, from $8.7 million in 1997 to $11.8 million in 1998. Total undistributed operating expenses include selling, general and administrative expenses, which increased 33.3% from $3.8 million in 1997 to $5.1 million in 1998, and depreciation and amortization, which increased 19.2% from $2.3 million in 1997 to $2.7 million in 1998. Total undistributed operating expenses as a percentage of total revenues decreased 2.7% from 35.7% in 1997 to 33.0% in 1998. The decrease in undistributed operating expenses as a percentage of total revenues is primarily attributed to the increased REVPAR and the company controlling sales and administrative expenses.

Operating income increased $3.0 million, or 63.0%, from $4.8 million in 1997 to $7.8 million in 1998. As a percentage of total revenues, operating income increased from 19.7% in 1997 to 21.8% in 1998. This increase is due primarily to an increase in REVPAR, the addition of seven hotels and improvements in the undistributed operating expense margins.

Interest expense decreased $0.5 million, or 11.9%, from $4.6 million in 1997 to $4.1 million in 1998. Interest expense declined as a result of the application of the net proceeds of the Offering to repay certain indebtedness, but is expected to increase in the future due to the funding of hotel acquisitions with additional debt.

Income tax provision increased 424.6%, from $0.3 million in 1997 to $1.3 million in 1998, due to the increase in the income before income taxes. The effective income tax rate for both periods was 34.0%.

Income before extraordinary item (noncash write off of deferred loan fees) increased $2.1 million, or 433.4%, from $0.5 in 1997 to $2.6 million in 1998.

COMPARISON OF THREE MONTHS ENDED JUNE 30, 1998 TO THREE MONTHS ENDED JUNE 30, 1997

Total revenues increased $7.4 million, or 53.7%, from $13.7 million in 1997 to $21.1 million in 1998. This increase is attributed primarily to revenue generated from increases in total rooms occupied and REVPAR and the addition of seven hotels.

Total hotel and restaurant revenues increased $7.0 million, or 62.0%, from $11.3 million in 1997 to $18.3 million in 1998. ADR for the Comparable Hotels increased $5.80, or 7.5%, from $77.55 in 1997 to $83.35 in 1998. REVPAR for the Comparable Hotels increased $4.99, or 9.7% from $51.49 in 1997 to $56.48 in 1998. The results reflect the addition of Cavanaughs Gateway Hotel, Cavanaughs Ridpath Hotel, Cavanaughs on the Falls, Cavanaughs Outlaw Hotel, Cavanaughs Hillsboro Hotel, Cavanaughs Olympus Hotel and Cavanaughs Templin's Resort which contributed, in part, to this increase in revenues.

Entertainment, management and services revenues increased $211,000, or 26.5% in 1998. Management and services revenue increased from the addition of new third-party management contracts.

Rental income increased $0.1 million, or 8.4%, from $1.6 million in 1997 to $1.7 million in 1998. This increase is due primarily to the addition of leased space in the Crescent Court property to The Travelers company which commenced occupancy in January 1998.

Direct operating expenses increased $3.3 million, or 58.4%, from $5.7 million in 1997 to $9.1 million in 1998, primarily due to the increase in the number of hotel guests served and the addition of seven hotels. This represents an increase in direct operating expenses as a percentage of total revenues from 41.8% in 1997 to 43.0% in 1998.

Total undistributed operating expenses increased $2.1 million, or 46.4%, from $4.6 million in 1997 to $6.7 million in 1998. Total undistributed operating expenses include selling, general and administrative expenses, which increased 47.5% from $2.1 million in

1997 to $3.1 million in 1998, and depreciation and amortization, which increased 22.2% from $1.2 million in 1997 to $1.4 million in 1998. Total undistributed operating expenses as a percentage of total revenues decreased 1.6% from 33.2% in 1997 to 31.6% in 1998. The decrease in undistributed operating expenses as a percentage of total revenues is primarily attributed to the increased REVPAR and the company controlling sales and administrative expenses.

Operating income increased $1.9 million, or 55.7%, from $3.4 million in 1997 to $5.3 million in 1998. As a percentage of total revenues, operating income increased from 25.0% in 1997 to 25.3% in 1998. This increase is due primarily to an increase in REVPAR, the addition of seven hotels and improvements in the undistributed operating expense margins.

Interest expense decreased $0.9 million, or 39.4%, from $2.3 million in 1997 to $1.4 million in 1998. Interest expense declined as a result of the application of the net proceeds of the Offering to repay certain indebtedness, but is expected to increase in the future due to the funding of hotel acquisitions with additional debt.

Income tax provision increased 221.1%, from $0.4 million in 1997 to $1.4 in 1998, due to the increase in the income before income taxes. The effective income tax rate for both periods was 34.0%.

Income before extraordinary item (noncash write off of deferred loan fees) increased $1.8 million, or 221.1%, from $0.8 in 1997 to $2.7 million in 1998.

LIQUIDITY AND CAPITAL RESOURCES

The Company's principal sources of liquidity are cash on hand, cash generated by operations and borrowings under a $80.0 million Revolving Credit Facility. Cash generated by operations in excess of operating expenses is used for capital expenditures and to reduce amounts outstanding under the Revolving Credit Facility. Hotel acquisitions, development and expansion have been and will be financed through a combination of internally generated cash, borrowing under credit facilities, and the issuance of common stock or OP Units.

The Company's short-term capital needs include food and beverage inventory, payroll and the repayment of interest expense on outstanding mortgage indebtedness. Historically, the Company has met these needs through internally generated cash.

The Company's long-term capital needs include funds for property acquisitions, scheduled debt maturities and renovations and other non-recurring capital improvements. The Company anticipates meeting its future long-term capital needs through the borrowing of additional debt financing secured by the Hotels, unsecured private or public debt offerings, additional equity offerings or the issuances of OP Units, along with cash generated from internal operations. In April 1998, the Company completed its initial public offering of 5,951,250 shares at $15.00 per share. The proceeds to the Company after deducting the underwriter's commission, but before other expenses, was $83.0 million. In April, the Company used the proceeds from the offering to repay approximately $68.6 million of debt, the balance was used to fund the acquisition of the fee interest in the Cavanaughs Ridpath and to acquire the Cavanaughs Hillsboro Hotel.

At June 30, 1998, the Company had $6.2 million in cash and cash equivalents, an increase of $1.3 million from $4.9 million on December 31, 1997. The Company has acquired six hotels during the six months ended June 30, 1998 and has expended $47.1 million for these acquisitions and capital expenditures. The Company establishes reserves for capital replacement in the amount of 4.0% of gross income to maintain the Hotels at acceptable levels. Acquired hotel properties have a separate capital budget for purchase, construction, renovation, and branding costs. Capital expenditures planned for Hotels in 1998 are expected to be approximately $3.0 million. Management believes the consistent renovation and upgrading of the Hotels and other properties is imperative to its long-term reputation and customer satisfaction.

To fund its acquisition program and meet its working capital needs, the Company has received an $80 million Revolving Credit Facility from U.S. Bank which was consummated on May 5, 1998. The interest rate is 185 basis points over LIBOR and declining to 165 basis points after six months if the Company maintains certain earnings before interest, taxes, depreciation and amortization (EBITDA) to debt ratios. The Revolving Credit Facility has an initial term of five years and an annualized fee for the unutilized portion of the facility. The Company selects from four different interest rates when it draws funds: the lender's prime rate or one, three, or six month LIBOR plus the applicable margin of 165 to 235 basis points, depending on the ratio of EBITDA to total funded debt. The Revolving Credit Facility has covenants that allow for the Company to draw funds based on the trailing 12 months performance on a pro forma basis for both acquired and owned properties. The Revolving Credit Facility allows the Company to choose which properties are part of the collateral base and, therefore, gives the Company the ability to utilize other long-term

credit facilities that may be more favorable to the Company. Funds from the Revolving Credit Facility may be used for acquisitions, renovations, construction and general corporate purposes. The Company believes the structure and availability of funds under the Revolving Credit Facility will be sufficient to meet the Company's long-term growth plans.

The Revolving Credit Facility contains various representations, warranties, covenants and events of default deemed appropriate for financing of a similar size and nature. Covenants and provisions in the definitive agreements governing the Revolving Credit Facility include, among other things, limitations on: (i) substantive changes in the Company's current business activities, (ii) liquidation, dissolution, mergers, consolidations, dispositions of material property or assets and acquisitions of property or assets of others, (iii) the creation or existence of liens on property or assets, (iv) the addition or existence of indebtedness, including guarantees and other contingent obligations, (v) loans and advances to others and investments in others, redemption of subordinated debt, (vi) amendment or modification of certain material documents or of the Articles in a manner adverse to the interests of the lenders under the Revolving Credit Facility, (vii) payment of dividends or distributions on the Company's capital stock, and (viii) maintenance of certain financial ratios. Each of the covenants described above will provide for certain ordinary course of business and other exceptions. If the Company breaches any of these covenants and does not obtain a waiver of that breach, the breach will constitute an event of default under the Revolving Credit Facility.

As of June 30, 1998, the Company had debt outstanding of $74.1 million consisting of primarily variable and fixed rate debt secured by individual properties. In April 1998, the Company completed its initial public offering and entered into the $80.0 million Revolving Credit Facility, which has $26.0 million outstanding at June 30, 1998 and $54.0 million available to be drawn.

The Company believes that cash generated by operations will be sufficient to fund the Company's operating strategy for the foreseeable future, and that any remaining cash generated by operations, together with capital available under the Revolving Credit Facility (subject to the terms and covenants included therein) will be adequate to fund the Company's growth strategy in the near term. Thereafter, the Company expects that future capital needs, including property acquisitions, will be met through a combination of net cash provided by operations, borrowings and additional issuances of Common Stock or OP Units.

SEASONALITY

The lodging industry is affected by normally recurring seasonal patterns. At most Hotels, demand is higher in the late spring through and early fall (May through October) than during the balance of the year. Demand also changes on different days of the week, with Sunday generally having the lowest occupancy. Accordingly, the Company's revenue, operating profit and cash flow are lower during the first and fourth calendar quarters and higher during the second and third calendar quarters.

INFLATION

The effect of inflation, as measured by fluctuations in the Consumer Price Index, has not had a material impact on the Company's revenues or net loss during the periods under review.

YEAR 2000

The Company does not believe that the costs of converting its computer systems to address the advent of the year 2000 will be material.

NEW ACCOUNTING PRONOUNCEMENTS

In June 1997, the Financial Accounting Standards Board (the "FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 131, Disclosures about Segments for an Enterprise and Related Information ("SFAS 131"). This Statement requires public companies to report selected segment information in their quarterly and annual reports issued to shareholders, and entity wide disclosures about products and services and major customers. The statement was adopted by the Company on January 1, 1998.

In June 1997, the FASB issued SFAS No. 130, Reporting Comprehensive Income. This Statement requires that comprehensive income be reported in a financial statement that is displayed with the same prominence as other financial statements. Comprehensive income is defined as the change in equity of a business enterprise arising from non-owner sources. This Statement was adopted by the Company on January 1, 1998.

Part II - Other Information

ITEM 1. LEGAL PROCEEDINGS

In 1994, the Company was sued by the contractor who constructed one of the Company's hotel properties asserting lack of payment of cost overruns. The Company filed a counter claim for the recovery of various damages. The Company obtained summary judgment for most of the claims. As of June 30, 1998, the amount of claims against the Company which have not been dismissed or are subject to appeal is $233,000, plus interest. The Company's counter claims which have not been dismissed are $419,000. Management believes that the ultimate resolution of this matter will not have a material effect on the Company's results of operations, financial condition or cash flows.

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

The Company's Registration Statement for its initial public offering of securities (File No. 333-44491) became effective on April 3, 1998.

Of the total net proceeds to the Company from the offering which are estimated to be in the amount of $81.4 million, the following amounts were used from the date of the offering through the date of this report:

Category of Use	Amount of Use
Purchases of real estate	$12.8 million
Repayment of indebtedness	68.6 million

None of the net proceeds to the Company of the offering was paid to directors, officers, ten percent shareholders or affiliates of the Company.

ITEMS 3, 4 and 5 of Part II are omitted from this report as they are not applicable.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

27.1 Financial Data Schedule

(b) Reports on Form 8-K

On June 12, 1998, the Company filed a Current Report on Form 8-K relating to The Olympus Hotel and Conference Center (Olympus). On August 14, 1998, the Company filed an Amendment No. 1 to said Report on Form 8-K/A to include the audited financial statements of Olympus.

CAVANAUGHS HOSPITALITY CORPORATION
SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

CAVANAUGHS HOSPITALITY CORPORATION
(Registrant)

Date: August 14, 1998

By: /s/ Arthur M. Coffey

Arthur M. Coffey, Executive Vice President and Chief Financial Officer

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